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WHAT WE TALK ABOUT WHEN WE TALK ABOUT TAX COMPLEXITY

*Andrea Monroe**

I. INTRODUCTION

I learned most of what I know about being a lawyer, a teacher, and a scholar from Professor Douglas Kahn. For four months in the spring of 1997, Doug mesmerized and terrified me in the class that I feared would be my academic downfall—Partnership Taxation. In the years that followed, Doug has been a mentor and friend, encouraging and supporting me at every stage of my professional career. And my experience is not unique: Doug has inspired generations of law students in just the same way.

There is no adequate way to thank Doug for everything he has given to students like me who have been lucky enough to sit in one of his classrooms. Doug is a force of nature—inspiring, challenging, and unquestionably dedicated to his students. Doug is the reason I became a tax lawyer, and he is also the reason that I became a law professor. Every day that I walk into a classroom, I try to do for my students what Doug did for me nineteen years ago. As a result, “thank you” has never felt like a serviceable way to communicate to Doug how grateful I am to have a role model like him.

I learned countless things about the federal income tax system from Doug, but three in particular have proven foundational. First, Doug taught me how to read the Internal Revenue Code and the related Treasury Regulations. He taught me the “language” of tax and the methods necessary to navigate its wonderfully technical terrain. Reading the tax law requires precision, care, and persistence, and Doug was relentless in teaching his students these skills. At the same time, Doug also showed us that the federal income tax was more than a complicated series of technical rules and standards. The system itself has a rhythm, which links together all of its intricate provisions through common themes like equity, efficiency, and administrability. Doug never allowed his students to lose sight of this rhythm, reminding us to rely on it when trying to make sense of new subchapters, new provisions, and new transactions.

Second, Doug taught me to read the tax law joyfully, nurturing a genuine appreciation for the legal craft values reflected in the federal income

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tax.¹ Despite its many flaws, Doug always made sure that his students understood the level of skill necessary to make the federal income tax system work. Consider subchapter K, which governs the taxation of partnerships and their partners. Someone had to operationalize the notion of pass-through taxation that lies at the heart of subchapter K, ensuring that all of a partnership's earnings were ultimately subject to a single level of tax at the partner level.² To this end, someone had to develop the concepts of inside basis, outside basis, capital accounts, and substantial economic effect that are essential to subchapter K's pass-through function.³ Likewise, someone had to write the section 704(b) regulations, blending these concepts into a system that would regulate the foundation of subchapter K—partnership allocations.⁴ And this was only the beginning. After section 704(b), someone had to tackle the related challenges, such as the allocation of partnership liabilities, allocations attributable to nonrecourse financing, and contributed property allocations.⁵ In designing

1. For purposes of this essay, I use the term “legal craft values” to refer to the experts’ appreciation of and appetite for technicality in the federal income tax, especially subchapter K. This definition of legal craft values is admittedly technocratic, focusing on the intricacy and elaboration reflected in the rules governing the taxation of partnerships and their partners. Although other definitions of legal craft values surely exist, this technocratic version best reflects today’s subchapter K. For a more detailed discussion of legal craft values, see *infra* note 9 and accompanying text.

2. Unlike individuals or corporations, a partnership is not a taxpayer. I.R.C. § 701 (2012). Instead, its partners are the proper taxpayers, paying tax annually on their share of the partnership’s income, gain, loss, and deduction. *Id.* § 704(a)–(b). Subchapter K thus performs a distinctive allocative function, dividing a partnership’s income among its partners annually. *Id.*

3. “Inside basis” measures the partnership’s tax investment in its individual properties; hence, it operates like most basis measures used in the federal income tax, focusing on investments in property. “Outside basis” measures a partner’s tax investment in her partnership interest. A capital account, in contrast, is a measure of a partner’s economic investment in a partnership. That is, the balance in a partner’s capital account is the amount that the partner would receive if the partnership were to liquidate her interest in the partnership. Treas. Reg. § 1.704-1(b)(2)(ii)(b)(2) (as amended in 2016).

“Substantial economic effect” is the notion at the heart of the rules governing partnership allocations. If a partnership’s allocation of income, gain, loss, or deduction complies with a regulatory safe harbor, requiring allocations to have substantial economic effect, then the allocation will be respected. I.R.C. § 704(b); Treas. Reg. § 1.704-1(b)(2)(i). If, however, the allocation lacks substantial economic effect, it will be reallocated based on subchapter K’s default allocation rule, which requires a partnership to allocate its taxable items based on the partners’ interests in the partnership. Treas. Reg. § 1.704-1(b)(3). In general terms, a partnership allocation will have substantial economic effect so long as the allocation reasonably tracks the partnership’s allocation of the corresponding economic item, as reflected in the partners’ capital accounts, and is not merely a device to shift income among the partners in a tax-advantaged manner. Treas. Reg. § 1.704-1(b)(2)(i), (ii)(a), (iii)(a).

4. Treas. Reg. § 1.704-1.

5. See, e.g., Treas. Reg. §§ 1.704-2 (as amended in 2011) (allocations attributable to nonrecourse liabilities), 1.704-3 (as amended in 2013) (allocations attributable to contributed property), 1.752-2 (as amended in 2006) (allocation of recourse liabilities), 1.752-3 (allocation of nonrecourse liabilities) (as amended in 2000); Prop. Treas. Reg. §§ 1.752-2, 79 Fed. Reg. 4826, 4835–4838 (Jan. 30, 2014) (revising the rules governing the allocation of recourse liabilities).

every rule, someone had to marry theory and practice in order to make partnership taxation work.

When considered in this light, subchapter K is truly extraordinary. It is an intricate system that highlights what is possible through legal craft. Doug celebrated this craft, even as he critiqued aspects of subchapter K's rules. Partnership taxation is far from perfect. It is complicated, too complicated for many partners. It can be a playground for partnerships intent on exploiting the tax law for financial gain, and it is often difficult to reconcile the myriad goals that the system seeks to achieve. Yet designing a system as intricate and nuanced as subchapter K is an awe-inspiring reminder of what talented tax professionals can do. And Doug never allowed his students to forget this.

Third, Doug taught me to never lose sight of the practical concerns that animate the federal income tax system. At the end of the day, the tax system must be accessible to taxpayers and administrable by the government. Real taxpayers need to file income tax returns annually, and they need to do so based on the law. If taxpayers cannot do this because the law is too complicated or too opaque, then the federal income tax does not work properly. To Doug, thinking about the federal income tax invariably meant thinking about taxpayers, their needs, and the many ways in which taxes impact all of our daily lives.

These three notions—reading the tax law, the role of legal craft, and the importance of administrative accessibility—form the basis of much of my teaching and scholarship. I want my students to learn to read the tax law. They may not recall all the technicalities of subchapter K once the semester ends, but I want them to feel confident in their ability to find the provisions they need and work through them in a precise and thorough manner. I also want my students to see the theoretical and practical magic of the federal income tax. Indeed, I want my students to fall in love with tax. That is what Doug did for me, and that is what I want to pass along to them.

Of equal importance, Doug's lessons have inspired much of my scholarship, which focuses on partnership taxation. Subchapter K is a system built on contradictions, thereby offering scholars a wealth of intellectual challenges. One such challenge is the aggregate–entity debate, namely whether we should think of a partnership as an aggregate of its owners or as an entity separate and distinct from them.⁶ Another is the question of

ties), 1.752-3, 79 Fed. Reg. 4826, 4838–4839 (Jan. 30, 2014) (revising the rules governing the allocation of nonrecourse liabilities).

6. Under the aggregate theory of partnerships, a partnership is effectively disregarded, with its partners treated as direct co-owners of each item of the partnership's property. Under the entity theory, in contrast, partners are treated like shareholders in a corporation owning separate and distinct interests in the partnership entity itself, rather than interests in the partnership's underlying property. Instead of adopting a uniform theory of partnerships, subchapter K follows both approaches, with different provisions reflecting different theories. Nonetheless, the aggregate theory animates subchapter K's pass-through function, which taxes partners directly on their share of the partnership's income. Accord-

reconciling subchapter K's competing values of equity, efficiency, flexibility, and simplicity.⁷ In each instance, there exist numerous ways to harmonize these discordant considerations, and the resulting scholarship is rich and diverse, with some scholarly works targeting particular provisions and others reimagining the entire system of partnership taxation.⁸

There is, however, an equally foundational contradiction within subchapter K that has not been explored in the scholarship. It is a contradiction that lies at the heart of Doug's lessons about the dual importance of legal craft values and practical functionality. More precisely: how do we reconcile our commitment to legal craft values with the need to have a federal income tax system that is accessible to taxpayers and administrable by the government? Partnership tax experts—whether in the private sector, the public sector, or the academy—share a deep loyalty to legal craft values, taking great pride in the ability to navigate subchapter K's intricate and endlessly challenging provisions.⁹ To these experts, legal craft values embody a common faith in the power of the tax law and the capacity of skilled professionals to manage the persistent challenges of modern part-

ingly, the aggregate theory serves as a useful touchstone when working through foundational issues in partnership taxation. *See, e.g.*, 2 AM. LAW INST., FEDERAL INCOME TAX STATUTE 354 (1954).

7. *See* S. REP. NO. 83-1622, at 89 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4621, 4721; H.R. REP. NO. 83-1337, at 65 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4017, 4091.

8. *See, e.g.*, GEORGE K. YIN & DAVID J. SHAKOW, AM. LAW INST., FEDERAL INCOME TAX PROJECT: TAXATION OF PRIVATE BUSINESS ENTERPRISES: REPORTERS' STUDY (1999); William D. Andrews, *Inside Basis Adjustments and Hot Asset Exchanges in Partnership Distributions*, 47 TAX L. REV. 3 (1991); Bradley T. Borden, *Aggregate-Plus Theory of Partnership Taxation*, 43 GA. L. REV. 717 (2009); Curtis J. Berger, *W(h)ither Partnership Taxation?*, 47 TAX L. REV. 105 (1991); Karen C. Burke, *Partnership Distributions: Options for Reform*, 3 FLA. TAX REV. 677 (1998); Emily Cauble, *Making Partnerships Work for Mom and Pop and Everyone Else*, 2 COLUM. J. TAX L. 247 (2011); Laura Cunningham, *Use and Abuse of Section 704(c)*, 3 FLA. TAX REV. 93 (1996); Noël B. Cunningham, *Needed Reform: Tending the Sick Rose*, 47 TAX L. REV. 77 (1991); Heather M. Field, *Choosing Tax: Explicit Elections as an Element of Design in the Federal Income Tax System*, 47 HARV. J. ON LEGIS. 21 (2010); Mark P. Gergen, *Reforming Subchapter K: Contributions and Distributions*, 47 TAX L. REV. 173 (1991); Jeffrey L. Kwall, *Taxing Private Enterprise in the New Millennium*, 51 TAX LAW. 229 (1998); Lawrence Lokken, *Taxation of Private Business Firms: Imagining a Future Without Subchapter K*, 4 FLA. TAX REV. 249 (1999); Andrea R. Monroe, *Integrity in Taxation: Rethinking Partnership Tax*, 64 ALA. L. REV. 289 (2012); Leigh Osofsky, *Unwinding the Ceiling Rule*, 34 VA. TAX REV. 63 (2014); Gregg D. Polsky, *Deterring Tax-Driven Partnership Allocations*, 64 TAX LAW. 97 (2010); Philip F. Postlewaite et al., *A Critique of the ALI's Federal Income Tax Project—Subchapter K: Proposals on the Taxation of Partners*, 75 GEO. L.J. 423 (1986); George K. Yin, *The Future Taxation of Private Business Firms*, 4 FLA. TAX REV. 141 (1999).

9. *See, e.g.*, Richard M. Lipton, "We Have Met the Enemy and He Is Us": *More Thoughts on Hyperlexis*, 47 TAX LAW. 1, 3–9 (1993); Bayless Manning, *Hyperlexis and the Law of Conservation of Ambiguity: Thoughts on Section 385*, 36 TAX. LAW. 9, 15 (1982); Bayless Manning, *Hyperlexis: Our National Disease*, 71 NW. U. L. REV. 767, 767 (1977). *See generally* Peter H. Schuck, *Legal Complexity: Some Causes, Consequences, and Cures*, 42 DUKE L.J. 1, 1 (1992) ("[Scholars] have a strong taste for complexity; indeed complexity amounts to a craft value . . .").

nership taxation, often through a targeted and surgical approach to subchapter K's rule design. Legal craft values thus represent a particularly cerebral vision of partnership taxation where perfection through elaboration is possible and technicality is celebrated.

This contradiction between legal craft values and administrability brings into focus one of the greatest challenges facing modern partnership taxation—complexity. It is no secret that subchapter K has a complexity problem.¹⁰ There is general agreement that subchapter K is too complicated, and any future partnership reform efforts, whether big or small, should prioritize simplification and administrability. Even so, the desire to simplify subchapter K raises a host of difficult questions for which little consensus exists. Perhaps most importantly is the question of what simplification means. Simplification and its counterpart—complexity—remain elusive concepts; indeed, it is not always clear what we mean when we talk about tax complexity.¹¹ Subchapter K has many stakeholders, including partners, tax professionals, and government officials. Within each stakeholder category, individuals possess varying degrees of wealth, access, sophistication, and expertise. This diversity of stakeholders presents a foundational question about the benchmark for assessing subchapter K's complexity. Specifically, which stakeholders function as the benchmark by which we measure the complexity of partnership taxation? Or, more generally, what does it mean when we say that subchapter K should “work better,” and whom should subchapter K work better for?

Taken together, these questions often make the notion of a simpler, more administrable subchapter K seems like an impossible goal. Yet the alternative is not without cost. Today's subchapter K is a byzantine web of technical language, multi-factored analyses, and computational tests. This complexity makes it difficult, if not impossible, for many partnerships to

10. See, e.g., Boris I. Bittker, *Tax Reform and Tax Simplification*, 29 U. MIAMI L. REV. 1 (1974); Steven A. Dean, *Attractive Complexity: Tax Deregulation, The Check-the-Box Election, and the Future of Tax Simplification*, 34 HOFSTRA L. REV. 405 (2005); James S. Eustice, *Tax Complexity and the Tax Practitioner*, 45 TAX L. REV. 7 (1989); Edward J. McCaffery, *The Holy Grail of Tax Simplification*, 1990 WIS. L. REV. 1267 (1990); Paul R. McDaniel, *Federal Income Tax Simplification: The Political Process*, 34 TAX. L. REV. 27 (1978); Martin J. McMahon, Jr., *Reflections on the Regulations Process: 'Do the Regulations Have to Be Complex' or 'Is Hyperlexis the Manna of the Tax Bar?'*, 51 TAX NOTES 1441 (1991); Sidney I. Roberts et al., *A Report on Complexity and the Income Tax*, 27 TAX L. REV. 325 (1972); Stanley S. Surrey, *Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail*, 34 LAW & CONTEMP. PROBS. 673 (1969).

11. See, e.g., Bittker, *supra* note 10, at 1 (“Neither ‘tax simplification’ nor its mirror image, complexity, is a concept that can be easily defined or measured. I know of no comprehensive analytic framework for these ideas, nor are there any empirical studies supplying a ‘simplicity index’ of particular areas of tax law or practice.”); McCaffery, *supra* note 10, at 1269 (“It is not easy to arrive at ready definitions of ‘simplicity’ and its cognates and antonyms. No single, uncontroversial definitions of these terms exist.”) (footnote omitted). Likewise, administrability is a similarly elusive concept in the federal income tax. See, e.g., Alice G. Abreu & Richard K. Greenstein, *The Rule of Law as a Law of Standards: Interpreting the Internal Revenue Code*, 64 DUKE L.J. ONLINE 53 (2015); Lawrence A. Zelenak, *Custom and the Rule of Law in the Administration of the Income Tax*, 62 DUKE L.J. 829 (2012).

comply with subchapter K's requirements without the assistance of a partnership tax expert. Absent this type of specialized tax advice, partnerships are forced to rely on what some scholars have referred to as an "intuitive" subchapter K where partnerships do the best they can with available resources and hope that their partners' returns are close enough to avoid drawing the attention of the Internal Revenue Service (IRS).¹²

The result is a deep schism between the theory and practice of partnership taxation. In theory, subchapter K is a one-size-fits-all system of taxation designed to accommodate a diverse array of business entities, whether big, small, sophisticated, or simple. In practice, however, subchapter K is a split system. In 2013, the most recent year for which partnership return information is available, approximately 346 million enterprises were treated as partnerships for federal income tax purposes.¹³ Less than 1% of these partnerships, "elite" partnerships with \$100 million or more in assets, generated approximately 63% of all partnership net income and held 75% of all partnership assets.¹⁴ At the other extreme is the "mainstream" of the partnership tax community. Approximately 92% of all partnerships held less than \$5 million in assets, and these partnerships generated approximately 19% of all partnership net income.¹⁵ Likewise, these mainstream partnerships held 6.9% of total partnership assets.¹⁶ There is thus a significant wealth gap within the partnership tax community, with a very small number of elite partnerships holding the vast majority of partnership wealth.

Alongside this gap, there is a related intellectual divide in partnership taxation. Elite partnerships rely on a cadre of experts—including partnership tax specialists, government officials, and the professoriate—to navigate the complicated law of subchapter K as drafted by Congress and the Department of the Treasury (Treasury). The mainstream of the partnership tax community lacks access to this elite professional cadre; hence, many, if not most, of these partnerships depend on generalist tax professionals or prepare their own federal income tax returns. For these mainstream partnerships and their mainstream advisors, subchapter K's

12. See Lawrence Lokken, *As the World of Partnership Taxation Turns*, 56 SMU L. REV. 365, 367 (2003) ("[W]e already have a K lite, consisting of the present subchapter K stripped of all the rules and nuances that tax practitioners serving ordinary partnerships do not understand and simply ignore."); Lokken, *supra* note 8, at 252 ("A large number of partnerships thus seem to be governed by what might be called an 'intuitive subchapter K.' Taxpayers and tax advisers who want to comply account for partnership transactions in ways that are consistent with their conceptions of the basic aims of subchapter K . . ."); Yin, *supra* note 8, at 201 ("[I]t may well be that many small firms . . . already utilize a watered-down, intuitive version of subchapter K.").

13. Ken DeCarlo & Nina Shumovsky, *Partnership Returns, 2013*, IRS STAT. OF INCOME BULL., fig.B (Fall 2015), <http://www.irs.gov/PUP/taxstats/soi-a-copa-id1512.pdf>.

14. *Statistics of Income Partnership Data by Size of Total Assets*, IRS tbl.15 (2013), <http://irs.gov/uac/SOI-Tax-Stats-Partnership-Data-by-Size-of-Total-Assets>.

15. *Id.*

16. *Id.*

complexity functions as a barrier to the law of partnership taxation.¹⁷ As a consequence, the partnership mainstream is often relegated to the intuitive version of subchapter K, relying on common sense and general intuitions about the federal income tax rather than the law itself.

The question facing us today is whether this is the subchapter K we want. It is in fact a particularly apt question considering the attention the federal income tax is receiving during the ongoing presidential election cycle. In recent months, several presidential candidates have proposed replacing the current Internal Revenue Code with a one- to three-page tax code, and another candidate has promised to eliminate the IRS if elected.¹⁸ One candidate has even asked voters how, if given a choice among implements, they would “kill” the tax code: with a chainsaw, a woodchipper, or fire?¹⁹ More generally, questions about the law and its relationship to wealth, privilege, and the elite permeate current politics.²⁰ And at the heart of this debate in the federal income tax context is the notion of complexity.

This essay offers an alternative perspective on tax complexity. To frame our thinking about complexity, it is important to consider the role of legal craft values in modern partnership taxation. Although largely unexplored in the tax literature, legal craft values have a profound impact on subchapter K, its complexity, and its future. Likewise, legal craft values are deeply engrained in the partnership tax experts who advise the partnership elite, many of whom were drawn to subchapter K precisely because of its technical and intellectual challenges.

For these partnership tax experts, legal craft values are foundational, shaping their perspective on partnership taxation and the merits of its un-

17. See Lokken, *supra* note 12, at 366 (“Even highly competent tax generalists may stumble badly on partnership issues not resolved by the basic pass-through idea of subchapter K.”); McMahon, *supra* note 10, at 1450 (“[R]egulations that are not too complex for a tax practitioner who specializes in the area with which the regulations deal often are too intricate to be understandable by the typical generalist who nevertheless must deal with those regulations in order to serve clients. We can’t all be specialists, and generalists can’t refer all their problems to specialists.”).

18. See, e.g., Rand Paul, *Simplify the Tax Code, Reduce the Budget, and Balance It*, NATIONAL REVIEW (Sept. 4, 2015), <http://www.nationalreview.com/article/423549/simplify-tax-code-reduce-budget-and-balance-it-rand-paul> (“I believe that the only way to rein in big government is to starve the beast. I’d eliminate the more than 70,000 pages of the tax code, replace it with one page, and start over.”); *Tax Reform*, CARLY FOR AMERICA, <https://carlyforamerica.com/carly-on-the-issues/tax-reform/> (last visited Jan. 30, 2016) (“We have to go to a three-page tax code. You lower every rate, you close every loophole. Why? Because the government uses the tax code to decide winners and losers.”); *The Simple Flat Tax Plan*, TED CRUZ, https://www.tedcruz.org/tax_plan/ (last visited Jan. 30, 2016) (“Cruz’s Simple Flat Tax abolishes the IRS and replaces the byzantine tax code with a simple, fair tax.”).

19. Rand Paul, *How Would You Kill the Tax Code?*, YOUTUBE.COM, <http://www.youtube.com/watch?v=LtglptO4v34> (last visited Jan. 30, 2016).

20. See, e.g., *Income and Wealth Inequality*, SANDERS, <https://berniesanders.com/issues/income-and-wealth-inequality/> (last visited Jan. 30, 2016) (“The issue of wealth and income inequality is the great moral issue of our time, it is the great economic issue of our time, and it is the great political issue of our time.”).

derlying rules. Yet to them, tax complexity is itself complicated. On the one hand, these experts understand the compliance and administrative challenges of today's subchapter K and largely share the aspirational goal of a simpler system of partnership taxation. On the other hand, they also experience the benefits of subchapter K's complexity. Complexity is often equated with more accurate and certain rules, rules that many experts consider a necessary element of a sophisticated economy and equitable society. At the same time, complexity creates opportunities for strategic partnerships and their advisors to exploit the tax law in order to obtain a financial advantage.²¹ Considered in this light, partnership tax experts are likely to tolerate, perhaps even demand, a much higher level of complexity in subchapter K. As a consequence, legal craft values function as a restraint on meaningful tax reform. That is, legal craft values trade off with simplification in partnership tax reform—the more one is willing to sacrifice legal craft in subchapter K, the more simplification is theoretically possible.

Two recently proposed regulations shed important light on the role of legal craft values in subchapter K, its complexity, and its schism.²² Both proposed regulations address transactions—contributions and distributions—that are common among all partnerships. One of the regulations explains the application of a newly codified statutory anti-abuse provision; the other reforms and modernizes one of subchapter K's most troublesome anti-abuse provisions. Nonetheless, both are grounded in a shared contradiction. The Treasury designed each of these proposed regulations to ease the compliance and administrative burdens associated with a specific transaction, whether by simplifying the rules or ensuring that they resonate with a particular audience. At the same time, both regulations place a high premium on legal craft values, relying on targeted, technical rules in order to draw a line between permissible and impermissible transactions. Indeed, what is most interesting about these two proposed regulations are the mechanisms, previously elective mechanisms, that the Treasury employs in its efforts to streamline subchapter K, and what those

21. Complexity in fact plays a larger role in the tax shelter problem. Complicated statutory and regulatory provisions lead to abusive transactions. These abuses, in turn, lead to complicated government responses, and then the cycle repeats, with subchapter K becoming more complicated and abusive transactions persisting. Despite this cycle, it is often argued that the governmental responses to tax shelters must be complicated in order to combat particular abuses without deterring legitimate partnership transactions. According to this argument, it is important that subchapter K be nuanced and accurate, even if the result is complicated rules. In doing so, Congress and the Treasury minimize the risk that subchapter K's rules will mischaracterize a transaction. Although the risk of mischaracterization is ubiquitous in the law, these risks are particularly salient in taxation because mischaracterization can transform an uncommon transaction into a common tax shelter. *See, e.g.,* David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 886 (1999).

22. Prop. Treas. Reg. §§ 1.704-3, 79 Fed. Reg. 3042, 3055–3060 (Jan. 16, 2014) (allocations attributable to property contributed with a built-in loss), 1.751-1, 79 Fed. Reg. 65151, 65159–65172 (Nov. 3, 2014) (hot asset distributions).

mechanisms signal about the relationship between legal craft values and partnership taxation.

For the partnership elite, these proposed regulations, as well as the craft-based approach to regulation they embody, make perfect sense. Put simply, they resonate with the elite members of the partnership tax community. The regulations are grounded in the shared technical language of elite experts, thereby allowing Treasury officials and private sector specialists to communicate efficiently for the benefit of a small number of partnerships. Of equal importance, the proposed regulations draw on existing partnership rules that these experts already understand, apply on an elective basis, and trust to achieve particular results. Through resonance and stability, the proposed regulations thus achieve tax simplification, leveraging legal craft values to ease the administrative burdens faced by the partnership elite.

Absent from this equation, however, is the partnership mainstream, raising the question of what the Treasury's craft-based approach to these proposed regulations means for the majority of the partnership tax community. For the partnership mainstream, these regulations are a potential nightmare. Elective provisions are common in partnership taxation, reflecting the diverse array of partnerships subject to subchapter K. The default rule is generally simple, and the elective rule is more complicated, designed for those partnerships willing to sacrifice simplicity in order to achieve more equitable and precise results. The election therefore serves as a safety value for mainstream partnerships—they can avoid some of subchapter K's complexity by not electing into particular rules.

The Treasury changed the balance in subchapter K by incorporating historically elective mechanisms into the most basic operating rules of the proposed regulations that are this essay's subject.²³ For the partnership mainstream, there is little resonance in these regulations, which build on a technical language and theoretical foundations that are not often accessible to them. As a result, the proposed regulations are just another set of exotic and unfamiliar rules that make subchapter K more complicated, burdensome, and inaccessible than it currently is. These challenges, in turn, create more distance between the partnership mainstream and the law, further entrenching the perception that subchapter K unfairly benefits the wealthy, well advised, and elite members of the partnership tax community. More generally, this split in subchapter K raises troubling questions about the fairness and legitimacy of the federal income tax system,

23. This essay focuses on the basic operating rules set forth in the proposed regulations issued under sections 704(c)(1)(C) and 751(b). In limiting this essay's focus to the baseline rules, my goal is to highlight the influence of legal craft values on the complicated rules that are most likely to impact all partnerships. Even so, these proposed regulations do in fact contain additional rules and additional complexity, which will be discussed in the relevant footnotes.

questions that, as previously discussed, are already a topic of great political debate.²⁴

This essay offers no answers. On the contrary, my goal is simply to offer some preliminary evidence of the pervasive influence of legal craft values in partnership taxation. Legal craft values shape our perception of the law, and they shape the law itself, orienting subchapter K toward the partnership elite with little express appreciation for the costs this craft-based approach imposes on the partnership mainstream. And scholars are not immune to the sway of legal craft values, which influence our work, as well as our efforts to reform the rules of partnership taxation. My hope is that this essay's focus on legal craft values will offer a fresh perspective on tax complexity, partnership tax reform, and the future of subchapter K.

II. COMPLEXITY AND PARTNERSHIP CONTRIBUTIONS

In January 2014, the Treasury published proposed regulations under section 704(c)(1)(C) that govern allocations attributable to property contributed to a partnership with an unrealized, or "built-in," loss (Proposed 704(c)(1)(C) Regulations).²⁵ Congress enacted Section 704(c)(1)(C) in 2004 as part of a comprehensive package of anti-tax shelter provisions to combat the shifting and duplication of losses through partnerships.²⁶ Section 704(c)(1)(C) sought to prevent the improper shifting of pre-contribution losses from a contributing partner to another partner, current or future, of the partnership.²⁷

The treatment of pre-contribution gains and losses has a long history.²⁸ When a partner contributes property to a partnership, the contribution is

24. See generally Elizabeth Warren, Op-Ed., *One Way to Rebuild Our Institutions*, N.Y. TIMES (Jan. 29, 2016) <http://www.nytimes.com/2016/01/29/opinion/elizabeth-warren-one-way-to-rebuild-our-institutions.html> ("Agency rules, executive actions and decisions about how vigorously to enforce certain laws will have an impact on every American, without a single new bill introduced in Congress. . . . Enforcement isn't about big government or small government. It's about whether the government works and who it works for.").

25. Prop. Treas. Reg. § 1.704-3, 79 Fed. Reg. at 3055–3060. For purposes of section 704(c)(1)(C), a "built-in loss" is defined as the difference between the property's basis and its fair market value at the time of contribution. I.R.C. § 704(c)(1)(C) (2012).

26. American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 833(a), 188 Stat. 1418, 1589 (codified at I.R.C. § 704(c)(1)(C)). As part of the same legislation, Congress also mandated inside basis adjustments to a partnership's property following sales of partnership interests having a substantial built-in loss and distributions involving a substantial basis reduction. *Id.* § 833(b)–(c). These partnership basis adjustments are discussed in greater detail *infra* note 58.

27. See STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 108TH CONGRESS 386–87 (Comm. Print 2005); H.R. REP. NO. 108-755, at 621 (Conf. Rep.) (2004), as reprinted in 2004 U.S.C.A.N. 1341, 1684–85; H.R. REP. NO. 108-548, at 281–83 (2004).

28. See, e.g., Cauble, *supra* note 8, at 249–50; Laura E. Cunningham & Noël B. Cunningham, *Simplifying Subchapter K: The Deferred Sale Method*, 51 SMU L. REV. 1, 4 (1997); Laura Cunningham, *Use and Abuse of Section 704(c)*, 3 FLA. TAX REV. 93, 94–95 (1996); Gergen, *supra* note 8, at 173; Gregory J. Marich & William S. McKee, *Sections 704(c) and*

treated as a nonrecognition event. Neither the contributing partner nor the partnership recognizes any gain or loss on the transaction.²⁹ Instead, any built-in gain or loss in the contributed property is preserved for future recognition in connection with a subsequent taxable event.³⁰ If, for instance, a partnership were to sell contributed property, only then—at the time of disposition—would the partnership recognize any pre-contribution gain or loss, along with any gain or loss attributable to post-contribution changes in the property's value.³¹ The question of how to allocate this recognized gain or loss, particularly the pre-contribution component, has been a perennial problem in subchapter K.

From a theoretical perspective, the answer is straightforward—a partnership should allocate any pre-contribution gain or loss exclusively to the contributing partner. Allocating pre-contribution gain or loss in this manner would align the contributing partner's economic investment in the partnership, which is measured by reference to the fair market value of the contributed property, with her tax investment in the partnership. In doing so, the contributing partner would bear the tax benefit or burden that corresponds to her economic investment in the partnership. Any other allocation would be inequitable, inappropriately shifting the pre-contribution gain or loss from the contributing partner to another partner. The contributing partner would no longer bear the tax benefit or burden associated with the contributed property; instead, another partner would bear the tax benefit or burden, presumably with the goal of reducing the partners' aggregate federal income tax liability at the expense of the public at large.³²

From a practical perspective, however, the answer is not as simple. Although a thorough examination of contributed property allocations is beyond this essay's scope, section 704(c) generally does require a partnership to allocate any built-in gain or loss recognized on the disposition of con-

743(b): *The Shortcomings of Existing Regulations and the Problems of Publicly Traded Partnerships*, 41 TAX L. REV. 627, 629 (1986); Andrea R. Monroe, *Saving Subchapter K: Substance, Shattered Ceilings, and the Problem of Contributed Property*, 74 BROOK. L. REV. 1381, 1391–92 (2009); Osofsky, *supra* note 8, at 72; John P. Steines Jr., *Partnership Allocations of Built-In Gain or Loss*, 45 TAX L. REV. 615, 615 (1990).

29. I.R.C. § 721(a).

30. *Id.* §§ 722 (partner's basis in partnership interest), 723 (partnership's basis in contributed property). When a partner contributes property to a partnership, the contributing partner takes the same basis in her partnership interest as she had in the contributed property. *Id.* § 722. The same is true for the partnership's basis in the contributed property—its initial basis in the property equals the contributing partner's basis in the property immediately before the distribution. *Id.* § 723.

31. *Id.* § 1001(a).

32. It is important to note that this type of income and loss shifting is temporary, reversing itself on the contributing partner's sale or liquidation of her partnership interest. Nonetheless, shifting transactions remains problematic because the offsetting allocations may not occur for many years, if at all. The longer it takes to reverse the income or loss shift, the more its effect begins to look permanent. *See, e.g.*, William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1124 (1974).

tributed property to the contributing partner.³³ But gaps remain in subchapter K's contributed property rules, allowing partnerships to shift pre-contribution gains or losses in order to obtain an improper financial advantage. Shifting transactions, particularly loss shifting transactions, have thus remained a persistent problem in partnership taxation.

A partnership can shift a pre-contribution loss among its partners in any number of ways, including through the sale of a partnership interest, the distribution of property, or, in some cases, the allocation rules themselves.³⁴ For instance, consider a partner who contributes built-in loss property to a partnership. If the contributing partner subsequently sells her partnership interest at a time when the partnership still holds the contributed property, then the purchasing partner will "step into the shoes" of the contributing partner.³⁵ That is, the purchasing partner will be treated as if she contributed the property and its built-in loss to the partnership. When the partnership ultimately sells the contributed property and recognizes this built-in loss, it will allocate the loss to the purchasing partner, thereby effectively, and improperly, shifting the pre-contribution loss from the contributing partner to the purchasing partner.³⁶

33. I.R.C. § 704(c)(1)(A); Treas. Reg. § 1.704-3 (as amended in 2013). Partnerships are permitted to choose, on a property-by-property basis, from a menu of allocation options. *Id.* § 1.704-3(a)(2). The default option is referred to as the "traditional method," where a partnership is generally required to allocate pre-contribution gains and losses to the contributing partner. *Id.* § 1.704-3(b)(1). The traditional method places a limit on contributed property allocations—a partnership's allocations attributable to contributed property cannot exceed the amount of gain or loss actually recognized by the partnership. *Id.* This limitation is commonly referred to as the "ceiling rule," and it applies in all instances, without exception. The advantage of the traditional method is its relative simplicity. When the ceiling rule applies, however, the traditional method often leads to inequitable results, shifting pre-contribution gains and losses among partners. For partnerships preferring a more equitable result, even at the price of greater complexity, the section 704(c) regulations provide two additional allocation options—the traditional method with curative allocations and the remedial allocation method. *Id.* § 1.704-3(c)–(d). Both of these methods seek to ameliorate the distortions created by the ceiling rule and, in doing so, prevent the shifting of pre-contribution gains and losses. For a discussion of these contribution property allocation methods, *see generally* WILLIAM S. MCKEE ET AL., *FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS* ¶ 11.04 (4th ed. 2007); ARTHUR B. WILLIS & PHILIP F. POSTLEWATE, *PARTNERSHIP TAXATION* ¶ 10.08 (7th ed. 2011).

34. *See supra* note 33. Section 704(c)'s general contributed property allocation rules only apply when a partnership-level event gives rise to an allocable item of income, gain, loss, or deduction. Partner-level events and nonrecognition transactions are thus not subject to section 704(c)'s allocation rules because these transactions do not give rise to taxable items requiring allocation among the partners. As a consequence, partnerships may use these transactions to shift pre-contribution gains and losses. Throughout the years, Congress has enacted numerous anti-abuse rules to combat the shifting of pre-contribution gains and losses. *See, e.g.*, I.R.C. §§ 704(c)(1)(B), 751(b). As will be discussed, section 704(c)(1)(C) is the most recent example of this type of statutory anti-abuse rule.

35. Treas. Reg. § 1.704-3(a)(7).

36. If a partnership makes a section 754 election or has a substantial built-in loss immediately after the sale of a partnership interest, then the partnership would make a basis adjustment to its property under section 743(b) in connection with the transfer of the partnership interest. In many instances, this basis adjustment would also serve to prevent the

Congress enacted section 704(c)(1)(C) to prevent this type of loss-shifting transaction.³⁷ In general terms, section 704(c)(1)(C) quarantines any pre-contribution loss with the contributing partner.³⁸ When a taxable event involving the contributed property occurs, a partnership is permitted to account for the built-in loss only in determining the consequences to the contributing partner.³⁹ For all other purposes and all other partners, the built-in loss does not exist.⁴⁰ In theory, section 704(c)(1)(C) thus prevents a partnership from shifting a pre-contribution loss among its partners—a partnership cannot shift a built-in loss that does not exist at the partnership level.⁴¹

Congress, as it often does, left the challenging task of operationalizing these new allocation rules to the Treasury. On January 16, 2014, almost a decade after section 704(c)(1)(C)'s enactment, the Treasury responded with the Proposed 704(c)(1)(C) Regulations.⁴² These proposed regulations create a new mechanism for allocations attributable to contributed built-in loss property and the related quarantine of pre-contribution losses. As provided in the statute, when a partner contributes built-in loss property to a partnership, the partnership's initial basis in the property equals its fair market value at the time of contribution.⁴³ The pre-contribution loss never transfers to the partnership. Accordingly, from the perspective of the partnership and the non-contributing partners, the built-in loss will have no impact on the future tax consequences attributable to the contrib-

shifting of pre-contribution losses among partners. I.R.C. §§ 743(b), (d), 754. For a more detailed discussion of the mandatory and elective section 743(b) basis adjustment, see *infra* note 58.

37. See STAFF OF JOINT. COMM. ON TAXATION, *supra* note 27, at 387–88; H.R. REP. NO. 108-755, at 621, (Conf. Rep.) (2004), as reprinted in 2004 U.S.C.C.A.N. 1341, 1684–85; H.R. REP. NO. 108-548, at 281–83.

38. I.R.C. § 704(c)(1)(C).

39. *Id.* § 704(c)(1)(C)(i).

40. *Id.* § 704(c)(1)(C)(ii).

41. Section 704(c)(1)(C) effectively repeals the ceiling rule with respect to contributed built-in loss property. As discussed *supra* note 33, ceiling rule problems arise when a partnership does not recognize sufficient gains or losses on the disposition of contributed property to avoid the shifting of pre-contribution gains or losses. This often occurs when there is a post-contribution reversal in the contributed property's fair market value—for example, when property with a pre-contribution loss appreciates in value following its contribution to the partnership. In this situation, the loss recognized on the property's disposition would be a net amount reflecting both the pre-contribution loss and the post-contribution gain. This net loss, in turn, would trigger the ceiling rule because the partnership would not actually recognize enough taxable loss to allocate an amount equal to the full pre-contribution loss to the contributing partner. A portion of the pre-contribution loss would thus shift from the contributing partner to the non-contributing partners. Section 704(c)(1)(C), by its terms, segregates the pre-contribution loss from any post-contribution gain or loss. Only the post-contribution gains and losses are now reflected at the partnership level. In doing so, section 704(c)(1)(C) ensures that the partnership will recognize sufficient amounts to prevent the shifting of any pre-contribution loss.

42. Prop. Treas. Reg. § 1.704-3, 79 Fed. Reg. 3042, 3055–3060 (Jan. 16, 2014).

43. I.R.C. § 704(c)(1)(C)(ii); Prop. Treas. Reg. § 1.704-3(f)(1)(ii), 79 Fed. Reg. at 3056.

uted property. Even so, the built-in loss does not entirely disappear; it remains available to the contributing partner. To this end, the Proposed 704(c)(1)(C) Regulations require a partnership to take the built-in loss into account when determining the consequences to the contributing partner of any subsequent taxable event involving the contributed property.⁴⁴

The proposed regulations preserve the pre-contribution loss through the “section 704(c)(1)(C) basis adjustment.” The section 704(c)(1)(C) basis adjustment initially equals the contributed property’s built-in loss at the time of contribution, and it is personal to the contributing partner.⁴⁵ Put another way, the section 704(c)(1)(C) basis adjustment is an adjustment to the basis of the contributed property that is available exclusively to the contributing partner in determining her tax consequences. It has no impact on the partnership or the partnership’s computation of income, gain, loss, or deduction attributable to the underlying contributed property.⁴⁶

To illustrate the proposed regulations’ treatment of pre-contribution losses, consider the following example. Two individuals form a partnership, each making equal contributions—one contributing cash and the other contributing built-in loss property—in exchange for equal partnership interests. The contribution of the built-in loss property is treated as a nonrecognition event, and the contributing partner therefore does not recognize the loss attributable to the contributed property.⁴⁷ The proposed regulations instead provide the contributing partner with a section 704(c)(1)(C) basis adjustment, which preserves the property’s pre-contribution loss for future recognition while ensuring that only the contributing partner receives any potential tax benefit attributable to the loss.⁴⁸ Consistent with this quarantine-based approach to pre-contribution losses, the partnership takes a basis in the contributed property equal to its fair market value at the time contribution, thereby eliminating all evidence of the pre-contribution loss at the partnership level.⁴⁹

If the partnership were to subsequently sell the contributed property, the proposed regulations would require the partnership to initially deter-

44. I.R.C. § 704(c)(1)(C)(i); Prop. Treas. Reg. § 1.704-3(f)(1)(i), 79 Fed. Reg., at 3056. The built-in loss is thus taken into account in determining the amount of income, gain, or loss allocated to the contributing partner on the taxable sale or exchange of the contributed property. Prop. Treas. Reg. § 1.704-3(f)(3)(ii)(C), 79 Fed. Reg. at 3056. Likewise, the built-in loss is taken into account when computing the amount of amortization, depreciation, or other cost recovery deductions that the contributing partner may take in a particular year. *Id.* § 1.704-3(f)(3)(ii)(D), 79 Fed. Reg. at 3056–57. The proposed regulations also contain detailed rules addressing the consequences of a subsequent transfer of contributed property through a nonrecognition transaction. *Id.* § 1.704-3(f)(3)(iv)–(v), 79 Fed. Reg. at 3058–60. These provisions govern the treatment of like-kind exchanges, distributions to a lower-tier partnership, contributions to a corporation, and distributions. *Id.*

45. Prop. Treas. Reg. § 1.704-3(f)(2)(iii), 79 Fed. Reg. at 3056.

46. *Id.* § 1.704-3(f)(3)(ii)(A), 79 Fed. Reg. at 3056.

47. I.R.C. § 721(a).

48. Prop. Treas. Reg. § 1.704-3(f)(3)(ii)(A), 79 Fed. Reg. at 3056.

49. I.R.C. § 704(c)(1)(C)(ii); Prop. Treas. Reg. § 1.704-3(f)(1)(ii), 79 Fed. Reg. at 3056.

mine the tax consequences of the property's sale without regard to the contributing partner's section 704(c)(1)(C) basis adjustment.⁵⁰ The partnership would compute the recognized gain or loss and allocate it equally between the partners.⁵¹ The non-contributing partner would thus recognize this gain or loss, which would reflect her share of any post-contribution changes in the value of the property. The determination of the contributing partner's tax consequences, however, would require an additional step—specifically, the partnership would need to account for the section 704(c)(1)(C) basis adjustment.⁵² To this end, the proposed regulations require the partnership to reduce the contributing partner's allocated share of taxable gain or loss by the amount of her section 704(c)(1)(C) basis adjustment.⁵³

When taken together, the proposed regulations would achieve the desired result: they eliminate the risk that the partnership will shift the pre-contribution loss from the contributing partner to the non-contributing partner through a disposition of contributed property.⁵⁴ The section

50. Prop. Treas. Reg. §. 1.704-3(f)(3)(ii)(A)–(B), 79 Fed. Reg. at 3056.

51. *Id.* More generally, a section 704(c)(1)(C) basis adjustment does not impact a partnership's computation of taxable items under section 703. *Id.* § 1.704-3(f)(3)(ii)(A), 79 Fed. Reg. at 3056. Likewise, the basis adjustment has no effect on the partners' capital accounts. *Id.* § 1.704-3(f)(3)(ii)(B), 79 Fed. Reg. at 3056.

52. *Id.* § 1.704-3(f)(3)(ii)(B)–(C), 79 Fed. Reg. at 3056.

53. *Id.* § 1.704-3(f)(3)(ii)(C), 79 Fed. Reg. at 3056. If the contributed property is subject to depreciation, amortization, or other cost recovery deductions, the section 704(c)(1)(C) basis adjustment would be recovered incrementally. *Id.* § 1.704-3(f)(3)(ii)(D), 79 Fed. Reg. at 3056–57. For instance, the contributing partner would recover the section 704(c)(1)(C) basis adjustment attributable to depreciable property using the same depreciable method and remaining recovery period as applies to the contributed property. *Id.* This amount would be added to the contributing partner's allocated share of annual depreciation deductions attributable to the contributed property. *Id.*

54. Additionally, the Proposed 704(c)(1)(C) Regulations prevent the shifting of pre-contribution losses to a transferee partner. If a contributing partner transfers all or a portion of her partnership interest, the portion of her section 704(c)(1)(C) basis adjustment attributable to the transferred interest is eliminated. *Id.* § 1.704-3(f)(3)(iii)(A), 79 Fed. Reg. at 3057. That is, the transferee partner no longer steps into the shoes of the contributing partner with respect to the contributed property. There is, however, an exception to this general rule for partnership interests transferred in a nonrecognition transaction. *Id.* § 1.704-3(f)(3)(iii)(B)(1), 79 Fed. Reg. at 3057. In these transactions, the transferee will be treated as the contributing partner, thus succeeding to the portion of the section 704(c)(1)(C) basis adjustment attributable to the transferred partnership interest. *Id.* Even so, the proposed regulations require the partnership to reduce the amount of the transferred section 704(c)(1)(C) basis adjustment by the amount of any negative section 743(b) basis adjustment that would have been allocated to the contributed property if the partnership had a section 754 election in effect at the time of transfer. *Id.*

The proposed regulations also contain rules governing nonrecognition transactions involving the contributed property. *Id.* § 1.704-3(f)(3)(iv)–(v), 79 Fed. Reg. at 3058–60. Although a detailed discussion of these rules is beyond this essay's scope, the rules typically serve to preserve the section 704(c)(1)(C) basis adjustment for the benefit of the contributing partner. *Id.* For example, if the partnership transfers the contributed property in a like-kind exchange, the replacement property is treated as the contributed property with the same section 704(c)(1)(C) basis adjustment. *Id.* § 1.704-3(f)(3)(iv)(A)(1), 79 Fed. Reg. at 3058.

704(c)(1)(C) basis adjustment would effectively quarantine the pre-contribution loss with the contributing partner. From the contributing partner's perspective, the contributed property's built-in loss would thus be preserved, and she would recognize this tax benefit when the partnership sells the property. From the non-contributing partner's perspective, however, the built-in loss would not exist. It would not be reflected in the partnership's basis in the contributed property, nor would it be taken into account when the partnership determines the tax consequences of the property's sale. On the contrary, the Proposed 704(c)(1)(C) Regulations would ensure that the non-contributing partner's tax consequences only reflect post-contribution changes in the value of the contributed property.

For readers familiar with subchapter K, this approach to pre-contribution loss allocations may seem familiar, tracking the elective basis adjustment provisions of section 743(b). In general terms, the section 743(b) basis adjustment is an elective adjustment to the basis of a partnership's property that is triggered by certain sales of partnership interests and that inures to the benefit of purchasing partners only.⁵⁵ The basis adjustment is designed, if elected, to correct a distortion that arises because the sale of a partnership interest triggers partner-level tax consequences without triggering corresponding consequences at the partnership level. When a partner purchases an interest in a partnership, her initial basis in the interest equals her cost.⁵⁶ The purchasing partner's basis therefore reflects the fair market value of her partnership interest and her corresponding share of the partnership's property at the time she purchased the partnership interest. The partnership's basis in its property, however, is not adjusted to reflect this partner-level transaction.⁵⁷ As a result, the purchasing partner's tax investment in the partnership, as reflected in her initial basis in her partnership interest, does not match her share of the partnership's basis in its property.⁵⁸

The same general treatment follows if the partnership contributes the property to a lower-tier partnership in a nonrecognition transaction. *Id.* § 1.704-3(f)(3)(iv)(B)(1), 79 Fed. Reg. at 3058. The upper-tier partnership's interest in the lower-tier partnership is treated the same as the contributed property, including with respect to the section 704(c)(1)(C) basis adjustment. *Id.* The proposed regulations do, however, contain a detailed set of rules governing the mechanics of section 704(c)(1)(C) and the section 704(c)(1)(C) basis adjustment in the tiered partnership context where subchapter K's pass-through function must account for the operation of multiple partnerships. *Id.* § 1.704-3(f)(3)(iv)(B), 79 Fed. Reg. at 3058. In addition, if a partnership distributes the contributed property to a partner other than the contributing partner, the partnership must reallocate the section 704(c)(1)(C) basis adjustment to the partnership's remaining property for the benefit of the contributing partner. *Id.* § 1.704-3(f)(3)(v)(B), 79 Fed. Reg. at 3059.

55. I.R.C. § 743(b) (2012); Treas. Reg. § 1.743-1(j) (as amended in 2004).

56. I.R.C. § 742.

57. *Id.* § 743(a).

58. More generally, subchapter K's pass-through function relies on equilibrium between the partners' aggregate outside basis in their partnership interests and the partnership's aggregate inside basis in its property. *See supra* note 3. Indeed, one can think of outside basis and inside basis as alternative measures of the same investment—the partners'

The difference between these two basis measures is their treatment of built-in gains or losses in the partnership's property that are attributable to the period before the purchase of the partnership interest: the purchasing partner's basis in her partnership interest includes her share of these built-in gains and losses, whereas the partnership's basis in the underlying property does not. Without an accurate measure of basis at the partnership level, a risk exists that these built-in gains or losses will be duplicated on a subsequent disposition of the partnership's property. Congress, however, provided elective, equitable relief for those partnerships willing to tolerate additional complexity in order to cure this type of basis distortion.⁵⁹ A partnership electing into the section 743(b) regime is required to adjust the basis of its property in order to ameliorate the mismatch between the purchasing partner's basis in her partnership interest and the partnership's basis in its property. As previously noted, this adjustment is made for the sole benefit of the purchasing partner, with the goal of absorbing her share

investment in the partnership enterprise. See Andrews, *supra* note 8, at 10; Cunningham, *supra* note 8, at 78; Gergen, *supra* note 8, at 349–50. When considered in this light, outside basis and inside basis are simply measuring the same investment from different vantages, with outside basis focused on the partners' partnership interests and inside basis focused on the partnership's properties. As a result, outside basis and inside basis typically respond in unison to taxable events affecting the partnership.

There are, however, certain partner-level events, such as sales of partnership interests and distributions, where the adjustments to outside basis at the partner level are not matched by corresponding adjustments to inside basis at the partnership level. I.R.C. §§ 734(a) (distributions), 743(a) (sales of partnership interests). In these instances, outside basis and inside basis will no longer be equal, compromising subchapter K's pass-through function. Put another way, inside basis no longer functions as an accurate measure of the partners' overall tax investment in the partnership because it fails to account for an event occurring at the partner level. For partnerships willing to tolerate additional complexity, Congress provided an elective remedy for this basis disequilibrium. *Id.* §§ 734(b), 743(b), 754. In general terms, a partnership electing into this statutory regime adjusts the inside basis of its properties following the sale of a partnership interest or certain triggering distributions, in each case, that create disparities between the partners' aggregate outside basis and the partnership's aggregate inside basis. *Id.* §§ 734(b), 743(b). As previously noted, Congress mandated the use of basis adjustments, even in the absence of an election, in order to prevent the shifting of certain losses among partners as part of the same legislation that included section 704(c)(1)(C). American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 833(b)–(c), 188 Stat. 1418 (codified as I.R.C. §§ 734(b), (d), 743(b), (d)). Thus, if a partnership has a substantial built-in loss immediately after the sale of a partnership interest, then it is required to make a section 743(b) basis adjustment with respect to the purchasing partner. I.R.C. § 743(b). A partnership has a substantial built-in loss if its inside basis in its property exceeds the fair market value of the property by more than \$250,000. *Id.* § 743(d). Comparable rules apply to distributions, where section 734(b) now mandates a basis adjustment in connection with distributions involving a substantial basis reduction. *Id.* § 734(b), (d). For a more detailed discussion of these elective basis adjustments, see generally McKEE ET AL., *supra* note 33, ¶¶ 24, 25; WILLIS & POSTLEWAITE, *supra* note 33, ¶¶ 12.03, 13.05.

59. I.R.C. §§ 743(b), 754. Once made, the section 754 election applies to all sales of partnership interests and triggering distributions, without exception. *Id.*

of any pre-purchase built-in gains or losses attributable to the partnership's property.⁶⁰

In designing the Proposed 704(c)(1)(C) Regulations, the Treasury drew heavily on the section 743(b) basis adjustment and its operational mechanics.⁶¹ The notion of a quarantined basis adjustment that is personal to a particular partner comes directly from section 743(b) and its treatment of purchasing partners.⁶² Likewise, the effects of the section 704(c)(1)(C) basis adjustment mimic those of the section 743(b) basis adjustment, with a partnership in each case only taking the relevant basis adjustment into account when determining the tax consequences to the affected partner.⁶³ Indeed, the preamble to the proposed regulations states that:

The Treasury Department and the IRS believe it is appropriate that the proposed regulations provide rules similar to those applicable to positive basis adjustments under section 743(b). The Treasury Department and the IRS believe that this approach simplifies the application and administration of section 704(c)(1)(C) and provides a framework of rules familiar to partners, partnerships, and the IRS.⁶⁴

By grounding the Proposed 704(c)(1)(C) Regulations in notions drawn from section 743(b), the Treasury signaled the importance of resonance in modern subchapter K and its regulatory design. The Treasury's goal was to leverage the partnership tax community's putative familiarity and experience with the mechanics of the section 743(b) basis adjustment. In doing so, the proposed regulations would ameliorate much of the complexity and administrative burdens associated with allocations attributable to built-in loss property.⁶⁵

This approach highlights the pervasive influence of legal craft values and the role they play in the Treasury's efforts to simplify subchapter K. The advantage of drawing on the section 743(b) basis adjustment is resonance—building on stable, familiar partnership provisions offers an efficient and streamlined way of introducing new mechanisms into subchapter K. Yet resonance will only produce these benefits if the partnership tax community has had exposure to and experience with the section 743(b) basis adjustment. If, however, large swaths of the partnership tax community are not familiar with the section 743(b) basis adjustment, then drawing on this complicated mechanism may not further the goals of sim-

60. Put another way, the goal of the section 743(b) basis adjustment is to provide the purchasing partner with a cost basis in her share of the partnership's property. When taken together, the purchasing partner's share of the partnership's inside basis plus the section 743(b) basis adjustment should equal her outside basis in her partnership interest immediately after the purchase.

61. Prop. Treas. Reg. § 1.704-3, 79 Fed. Reg. 3043, 3047 (Jan. 16, 2014).

62. Treas. Reg. § 1.743-1(j)(1) (as amended in 2004).

63. *Id.* § 1.743-1(j); Prop. Treas. Reg. § 1.704-3(f)(3)(ii)(A)–(B), 79 Fed. Reg. at 3056.

64. Prop. Treas. Reg. § 1.704-3(f), 79 Fed. Reg. at 3043, 3047.

65. *Id.*

plification and administrability. Indeed, it may prove counterproductive, complicating rather than simplifying subchapter K.

There is reason to believe that the Treasury's approach will not resonate with the mainstream of the partnership tax community. As previously discussed, determining the basis consequences of a sale of a partnership interest is complicated; hence, only electing partnerships are currently required to make the section 743(b) basis adjustment in most instances.⁶⁶ And the evidence, although scant, suggests that few partnerships in fact make the election necessary to trigger the section 743(b) basis adjustment. In 2013, for example, only 5.5% of all partnerships had made the requisite election.⁶⁷ While exceptions surely exist, it is reasonable to conclude that the vast majority of non-electing partnerships—that is, 94.5% of all partnerships—have at best peripheral familiarity with the section 743(b) basis adjustment. Thus, for most partnerships, the Proposed 704(c)(1)(C) Regulations are just another novel and technical set of rules to be applied in the already complicated world of contributed property allocations.

In fact, the Proposed 704(c)(1)(C) Regulations might feel particularly troublesome to many in the partnership tax community, introducing complicated, historically elective rules into subchapter K for the benefit of the partnership elite with little appreciation for their adverse impact on the partnership mainstream.⁶⁸ To the mainstream of the partnership tax com-

66. There is, however, one important exception where Congress now mandates that partnerships make a section 743(b) basis adjustment, even in the absence of a section 754 election. For a more detailed discussion of this mandatory basis adjustment, see *supra* note 58.

67. *Publication 5035: Statistics of Income—2013 Partnership Returns Line Item Estimates*, IRS 5 (2013) <http://www.irs.gov/pub/irs-soi/13palineitemestimates.pdf>. Although the following numbers do not offer a perfectly accurate measure of the partnership tax community's familiarity with the section 743(b) basis adjustment, they do provide some sense of how few partnerships actually elect to make the optional basis adjustment. In 2013, 3,460,699 partnerships filed informational partnership tax returns. *Id.* at 1. Of those partnerships, 190,211—approximately 5.5% of all partnerships—made a section 754 election in 2013 or had an election in effect from a previous taxable year. *Id.*, at 5. Within this universe of partnerships having a section 754 election in effect, only 38,845 partnerships, or approximately 1.1% of all partnerships, made an optional basis adjustment under section 734(b) or section 743(b) during the taxable year. *Id.* at 5. Likewise, only 1,287 partnerships, or approximately .04% of all partnerships, made a mandatory basis adjustment in 2013 as a result of a substantial built-in loss under section 743(d) or a substantial basis reduction under section 734(d). *Id.* at 5.

68. One might argue that the Treasury is only following the lead of Congress in mandating the use of previously elective provisions, particularly with respect to these anti loss-shifting rules. As discussed *supra* note 26, Congress enacted section 704(c)(1)(C) along with a series of anti-abuse measures, including two rules requiring partnerships to make inside basis adjustments in situations where a partnership has not made a section 754 election. I.R.C. §§ 734(b), (d), 743(b), (d) (2012). Although these anti-abuse rules do in fact require partnerships to apply historically elective mechanisms, Congress struck a different balance in incorporating these now mandatory provisions into subchapter K. Both mandatory basis adjustment rules effectively carve out smaller transactions, excluding those that involve the shifting of losses of \$250,000 or less. Prop. Treas. Reg. §§ 1.734-1, 79 Fed. Reg. 3042, 3043 (Jan. 16, 2014) (“According to the legislative history, Congress intended these amendments

munity, these proposed regulations reinforce the perception that the Treasury prioritizes the needs of the partnership elite over the partnership mainstream. The Proposed 704(c)(1)(C) Regulations are oriented toward the elite members of the partnership tax community, those who are most likely to have experience with the section 743(b) basis adjustment. The partnership elite thus seem to be the apparent target of the Treasury's efforts at simplification and enhanced administrability in subchapter K. Likewise, the partnership elite seem to be the benchmark against which subchapter K's complexity is measured. The mainstream of the partnership tax community, in contrast, appear to be absent from this calculation.

III. COMPLEXITY AND PARTNERSHIP DISTRIBUTIONS

Recently proposed regulations under section 751(b) (Proposed 751(b) Regulations), which govern the treatment of certain partnership distributions, offer another glimpse into the relationship between complexity and legal craft values in subchapter K. The Treasury proposed these regulations in October 2014 with the goal of simplifying and modernizing section 751(b), which is perhaps subchapter K's most infamous anti-abuse rule.⁶⁹ When originally enacted in 1954, section 751(b)'s primary target was distributions that converted the character of partnership income, gain, or loss.⁷⁰ Over time, however, section 751(b) and its "hot asset" distribution rules have become subchapter K's primary bulwark against a diverse array of distribution-related abuses, including income shifting and excess deferral transactions.⁷¹

The basic notion animating partnership distributions is straightforward—to the extent that subchapter K's rules can ensure that all of a partnership's income is ultimately subject to tax at the partner level, then the partnership is permitted great latitude in distributing property to its partners. Operationally, this translates into a general nonrecognition rule for partnership distributions, where neither the partnership nor the distribu-

to prevent the inappropriate transfer of losses among partners, while preserving the simplification aspects of the existing partnership rules for transactions involving smaller amounts (as described in this preamble, a \$250,000 threshold).").

69. I.R.S. Notice 2006-14, 2006-1 C.B. 498, § 2. In revising the rules governing hot asset distributions, the Treasury had myriad goals, including simplification, modernization, easing the administrative burdens associated with section 751(b) transactions, and correcting flaws in the existing regulations' mechanics. *Id.*

70. *Id.*; see also AM. LAW INST., FEDERAL INCOME TAX PROJECT—SUBCHAPTER K: PROPOSALS ON THE TAXATION OF PARTNERS 51–55 (1984); Andrews, *supra* note 8, at 4 ("The original purpose for this provision had primarily to do with the distinction between capital gain and ordinary income rates, more than timing of gain recognition, but it currently functions to set an important, though inadequate limit on unreasonable postponement of tax.").

71. See Andrews, *supra* note 8, at 4; see also Andrea R. Monroe, *The New Revolution in Partnership Tax?*, 33 VA. TAX REV. 269, 295 (2013).

tee partner recognizes gain or loss on the transaction.⁷² There are thus generally no immediate tax consequences of a distribution; instead, any built-in gain or loss attributable to the distributed property or the distributee partner's partnership interest is deferred for future recognition at a more appropriate time.⁷³

This nonrecognition-based approach to partnership distributions is not without its flaws. A general nonrecognition rule, standing alone, creates opportunities for partnerships to structure distributions that produce improper tax advantages for their partners. When Congress originally codified subchapter K, it was most concerned about distributions that converted ordinary income into preferentially taxed capital gains.⁷⁴ When a partnership sells property, the character of any gain or loss recognized is determined at the partnership level, based on the partnership's use of the property.⁷⁵ If the property were instead distributed to a partner, the character of any gain or loss recognized on the partner's subsequent sale of the property would be determined based on the partner's use of the property. It follows that a strategic partnership could use a distribution to exploit a tax rate differential in order to reduce its partners' aggregate tax liability.⁷⁶

72. I.R.C. §§ 731(a) (nonrecognition for distributee partner), 731(b) (nonrecognition for partnership). There are in fact several exceptions to this general nonrecognition rule. If, for instance, a partner receives a cash distribution in excess of her basis in her partnership interest, she must recognize gain equal to such excess cash distribution. *Id.* § 731(a)(1). Similarly, certain distributions in complete liquidation of a partnership interest give rise to recognized losses. *Id.* § 731(a)(2).

73. *Id.* §§ 732 (partner's basis in distributed property), 733 (partner's basis in partnership interest). In general terms, a partner takes a basis in distributed property equal to the partnership's basis in such property immediately before the distribution. *Id.* § 732(a). The distributee partner, however, cannot take a basis in the distributed property greater than her outside basis reduced by any cash distributed in the transaction. *Id.* § 732(a)(2). The distributee partner also adjusts her basis in her partnership interest, reducing it by any cash received plus her basis in the distributed property. *Id.* § 733. In one respect, the basis consequences of a complete liquidating distribution differ from these general rules. Since the liquidated partner relinquishes her partnership interest in the distribution, her entire pre-distribution basis in her partnership interest must transfer to the distributed property. Therefore, the liquidated partner's basis in the distributed property equals her basis in her partnership interest minus any cash received in the distribution. *Id.* § 732(b).

74. At the time of subchapter K's codification in 1954, individual income tax rates were as high as ninety-one percent, while the capital gains rate was only twenty-five percent. I.R.C. §§ 1(a), 1201(b) (1954).

75. *Id.* § 702(b) (2012).

76. Alongside character conversions, distributions can also be used to shift gain and loss among partners. Consider the consequences of a partnership's distribution of appreciated property. The distribution itself triggers no immediate tax consequences to the partnership or the distributee partner. *Id.* § 732(a)–(b). The distributed property's built-in gain is thus deferred for future recognition, with the distributee partner taking the partnership's basis in the property. *Id.* § 732(a). If the partnership had instead sold the property, it would recognize a taxable gain and allocate the gain among its partners based on their contractual sharing arrangement. *Id.* §§ 704(b), 1001. That is, all of the partners would have shared the resulting tax burden. The partnership's decision to distribute the property changes this out-

To combat character shifting distributions, Congress thus enacted a series of anti-abuse rules, with section 751(b) being the most notable.⁷⁷ In general terms, section 751(b) recharacterizes certain distributions as taxable exchanges between the partnership and the distributee partner.⁷⁸ If, for instance, a partner receives a distribution of ordinary, or “hot,” assets in excess of her proportionate share of the partnership’s hot assets, section 751(b) would treat the transaction as an exchange instead of a nonrecognition event.⁷⁹ In this recharacterized transaction, the distributee partner would receive the excess share of hot assets from the partnership and, in exchange, she would relinquish her share of the partnership’s other, generally capital, assets. The transaction would be a fully taxable event, with both the distributee and the non-distributee partners potentially recognizing gain or loss.

Although a comprehensive discussion of section 751(b)’s hot asset distribution rules is beyond this essay’s scope, two aspects of this anti-abuse rule warrant mention. First, section 751(b) is tremendously complicated. When applicable, it has historically required a partnership to navigate a seven-step computational process that involves three fictional transactions between the partnership and the distributee partner.⁸⁰ For many, section

come, shifting the entire tax burden to the distributee partner. If, after the distribution, the distributee partner sells the property, she will be responsible for all of the resulting taxable gain. As previously discussed, it is important to note that this type of income and loss shifting is only temporary, reversing itself on the partner’s disposition or liquidation of her partnership interest. *See supra* note 32.

77. I.R.C. §§ 731(a)(2) (loss recognized on certain complete liquidating distributions), 735 (look-through character rule for partner’s sale of certain distributed property), 751(b) (certain distributions recharacterized as taxable exchanges). Congress enacted all three of these provisions as part of subchapter K’s initial codification in 1954. *Id.* §§ 731(a)(2), 735, 751(b) (1954).

78. *Id.* § 751(b)(1) (2012). For a detailed discussion of section 751(b), see generally MCKEE ET AL., *supra* note 33, ¶ 21; WILLIS & POSTLEWAITE, *supra* note 33, ¶ 14.

79. Technically, a distribution triggers section 751(b) when the distributee partner receives a disproportionate share of the partnership’s unrealized receivables or substantially appreciated inventory, together referred to as “hot” assets. I.R.C. § 751(b)(1). A distribution similarly triggers section 751(b) when the distributee partner receives a disproportionate share of the partnership’s other assets, including cash, which are referred to as “cold” assets. *Id.* In order to determine whether section 751(b) applies to a distribution, it is thus necessary to divide a partnership’s assets into two character-based categories—hot assets and cold assets. *Id.* § 751(b)(3) (substantial appreciation), (c) (unrealized receivables), (d) (inventory).

80. MCKEE ET AL., *supra* note 33, ¶ 21.03. In order to operationalize section 751(b)’s recharacterization of a distribution as an exchange transaction, the actual distribution is broken into three fictional transactions. First, the distributee partner needs to obtain the property that she is deemed to exchange with the partnership. The first notional transaction thus involves a distribution to the partner of the property that she is treated as relinquishing in the exchange transaction. Treas. Reg. § 1.751-1(b)(2)(iii), (g), ex. 3(d)(1) (as amended in 2004). For instance, if a partner received a distribution of hot assets in excess of her proportionate share of the partnership’s hot assets, section 751(b) would treat the partner as relinquishing a share of the partnership’s cold assets in exchange for the excess hot assets. In this first notional transaction, the partnership would therefore distribute cold assets to the partner. The second notional transaction is the taxable exchange, where the partner transfers the property

751(b) is nothing short of maddening. It is thus no surprise that these hot asset distribution rules are often described as subchapter K's "least understood and most widely ignored" rules.⁸¹

Second, section 751(b) is structurally flawed; hence, it often fails to prevent the abuses Congress sought to eliminate.⁸² For instance, one of section 751(b)'s most notable flaws is its triggering mechanism—section 751(b) is triggered by distributions that are "disproportionate," where the distribution reduces a partner's share of the partnership's hot assets, as measured by their gross asset value.⁸³ Accordingly, if a partner holding a one-third interest in a partnership receives a distribution in complete liquidation of her partnership interest, she must receive one-third of the partnership's hot assets, as determined by their fair market value at the time of the distribution, in the transaction. If she receives any other proportion of the partnership's hot assets, the distribution will be considered disproportionate, thereby triggering section 751(b).

Herein lies a problem: by focusing on gross asset value rather than built-in gain, section 751(b)'s triggering mechanism is too narrow, failing to identify certain distributions that result in a character conversion. Consider, for example, a two-person partnership that holds a number of assets, including two hot assets of equal value—one hot asset has a significant built-in gain and the other has no built-in gain. If the partnership distrib-

received in the notional distribution to the partnership and, in exchange, receives the excess portion of the property received in the actual distribution. *Id.* § 1.751-1(b)(2)(ii), (g) ex. 3(c), (d)(1), (e)(1). Returning to the example, the distributee partner would therefore exchange, in a fully taxable transaction, the cold assets received in the first notional step for the disproportionate share of hot assets received in the actual distribution. The third, and final, notional transaction is a distribution of the remaining portion of property actually distributed to the partner. *Id.* § 1.751-1(g) ex. 3(d)(2), (e)(2).

At the risk of stating the obvious, determining the tax consequences of this recharacterized transaction is not easy. Accordingly, the Proposed 751(b) Regulations attempt to streamline these complicated mechanics. Prop. Treas. Reg. § 1.751-1(b)(3), 79 Fed. Reg. 65151, 65161 (Nov. 3, 2014). The approach adopted in the proposed regulations will be discussed *infra* note 104.

81. James S. Eustice, *Subchapter S Corporations and Partnerships: A Search for the Pass Through Paradigm (Some Preliminary Proposals)*, 39 TAX L. REV. 345, 383 (1984).

82. Section 751(b)'s many flaws are well documented, and calls for the anti-abuse rule's repeal began shortly after its enactment in 1954. *See, e.g.*, STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 86TH CONG., SUMMARY OF THE SUBCHAPTER K ADVISORY GROUP RECOMMENDATIONS ON PARTNERS AND PARTNERSHIPS 40 (1959); A.B.A. TAX SECTION RECOMMENDATION NO. 1974-11, *reprinted in* 27 TAX LAW. 839, 842 (1974); AM. LAW INST., *supra* note 70, at 51–55; AM. LAW INST., FEDERAL INCOME TAX PROJECT—TAXATION OF PRIVATE BUSINESS ENTERPRISES: MEMORANDUM NO. 3 65–77 (1997); Andrews, *supra* note 8, at 52–55; Berger, *supra* note 8, at 147; Burke, *supra* note 8, at 713–17; Eustice, *supra* note 81, at 381–85; Gergen, *supra* note 8, at 200; Christopher H. Hanna, *Partnership Distributions: Whatever Happened to Nonrecognition?*, 82 KY. L.J. 465, 469–85 (1994); Andrea R. Monroe, *Taxing Reality: Rethinking Partnership Distributions*, 47 LOY. L.A. L. REV. 657, 698–703 (2014); Postlewaite et al., *ALI Critique*, *supra* note 8, at 596–611; E. George Rudolph, *Collapsible Partnerships and Optional Basis Adjustments*, 28 TAX L. REV. 211, 217 (1957); Yin, *supra* note 8, at 233–38.

83. I.R.C. § 751(b); Treas. Reg. § 1.751-1(g), exs. 2, 3.

utes one hot asset to each partner, the transaction would not trigger section 751(b). Each partner would have received exactly her share of the partnership's hot assets, as measured by their fair market value.

Nonetheless, this distribution would be disproportionate, shifting all of the partnership's built-in ordinary gain to one partner. Had the partnership sold the hot assets instead of distributing them, the partnership would have recognized an ordinary gain on the appreciated hot asset's sale and allocated this gain equally between the two partners. As a result of the distribution, however, one of the partners will now hold the appreciated hot asset in her individual capacity. This partner will thus be responsible for the entire taxable gain on a subsequent sale of the distributed hot asset. Although this distribution would not trigger section 751(b), it is precisely the type of abusive transaction that should be recharacterized by the hot asset distribution rules.

In 2006, the Treasury published Notice 2006-14, which informed the partnership tax community that it was considering the reform of the section 751(b) regulations.⁸⁴ The Treasury explained its decision to reform section 751(b) in the following manner:

The current regulations under § 751(b) were published in 1956 and have not been amended to reflect significant changes in subchapter K and in the operations of contemporary partnerships. Moreover, the current § 751(b) regulations have been widely criticized as being extraordinarily complex and burdensome and as not achieving the objectives of the statute.⁸⁵

The goal was to revise the hot asset distribution rules in order to “better achieve the purpose of the statute while providing greater simplicity.”⁸⁶ Eight years later, the Proposed 751(b) Regulations were published.⁸⁷

The Proposed 751(b) Regulations reformed many aspects of the hot asset distribution rules, including its triggering mechanism. Distributions that reduce any partner's share of the partnership's hot assets continue to trigger section 751(b).⁸⁸ The proposed regulations, however, replace the

84. I.R.S. Notice 2006-14, 2006-1 C.B. 498. The partnership tax community responded to the notice with robust and largely positive commentary. See, e.g., A.B.A. SECTION OF TAXATION, COMMENTS CONCERNING NOTICE 2006-14, *reprinted in* 2007 TNT 82-22 (Apr. 27, 2007); William D. Andrews, *Comments on Notice 2006-14*, *reprinted in* Daily Tax Rep. (BNA) No. 230, at G-10 (Nov. 28, 2006); Karen C. Burke, *Remedying Flaws in the Hot Asset Sale Approach*, 116 TAX NOTES 267 (July 23, 2007); N.Y. STATE BAR ASS'N TAX SECTION, REPORT RESPONDING TO NOTICE 2006-14 RELATING TO THE TREATMENT OF PARTNERSHIP DISTRIBUTIONS UNDER SECTION 751(B), *reprinted in* 2006 TNT 230-8 (Nov. 30, 2006).

85. I.R.S. Notice 2006-14 § 2.

86. Prop. Treas. Reg. § 1.751-1, 79 Fed. Reg. 65151, 65152 (Nov. 3, 2014).

87. *Id.*

88. *Id.* § 1.751-1(b)(2)(i), 79 Fed. Reg. at 65160. Technically, the proposed regulations provide that section 751(b) applies to a distribution if the transaction “gives rise to a ‘section 751(b) amount’ for any partner.” *Id.* A partner's section 751(b) amount, in turn, equals the greatest of three amounts: (1) the excess of the partner's net section 751(b) unrealized gain before the distribution and her net section 751(b) unrealized gain after the distribution; (2) the excess of the partner's net section 751(b) unrealized loss after the distribution and her net section 751(b) unrealized loss before the distribution; and (3) the sum of the partner's net

old regulations' "gross asset value" approach to disproportionality with a focus on the built-in gain in the partnership's hot assets.⁸⁹ To operationalize this new focus, the Treasury adopted a hypothetical sales approach, where a partnership determines whether a distribution is disproportionate by comparing the consequences of a sale of its hot assets before the distribution to a sale of the same assets after the distribution.⁹⁰ If all of the partners would be allocated the same amount of ordinary income in the pre-distribution and post-distribution hypothetical sales, then the distribution will be considered proportionate, and section 751(b) will not apply.⁹¹

There is, however, one wrinkle in the hypothetical sales approach, one that reflects the Treasury's dual goals of simplifying and modernizing section 751(b). The Proposed 751(b) Regulations mandate "revaluations" in applying the hypothetical sales approach to certain distributions.⁹² More specifically, when a partnership distributes property in partial or complete liquidation of a partner's partnership interest and the partnership holds hot assets following the transaction, the partnership is required to revalue its assets pursuant to a technical and previously elective series of regulatory requirements.⁹³ Incorporating mandatory revaluations into the proposed regulations, it was hoped, would reduce the number of distributions that would trigger section 751(b) and its complicated rules.⁹⁴

In general terms, revaluations regulate transactions that represent transformative economic changes to a partnership, like contributions and

section 751(b) unrealized gain before the distribution and her net section 751(b) unrealized loss after the distribution. *Id.*

89. *Id.* § 1.751-1(b)(2), 79 Fed. Reg. at 65160. This shifted focus is evident in the computation of the section 751(b) amount, which is computed by reference to each partner's share of the unrealized gain or loss attributable to the partnership's hot assets. *Id.*

90. *Id.* That is, the net section 751(b) unrealized gain or loss is computed by determining the amount of net income or loss that the partnership would allocate to each partner if the partnership were to sell all of its hot assets for their fair market value. *Id.* § 1.751-1(b)(2)(ii)–(iii), 79 Fed. Reg. at 65160. When determining the distributee partner's net section 751(b) unrealized gain or loss after the distribution, the partnership must also take into account any distributed hot assets, computing the amount of gain or loss that the partner would recognize on a hypothetical sale of the distributed property for its fair market value. *Id.* § 1.751-1(b)(2)(iii)(B), 79 Fed. Reg. at 65160.

91. In this instance, the distribution would not result in a section 751(b) amount for any partner. *Id.* § 1.751-1(b)(2)(i), 79 Fed. Reg. at 65160.

92. *Id.* § 1.751-1(b)(2)(iv), 79 Fed. Reg. at 65160–65161. Additionally, the Proposed 751(b) Regulations contain a look-through rule requiring tiered revaluations in certain circumstances. *Id.* If the same persons own, directly or indirectly, more than 50 percent of the capital and profits interests in both the upper and lower-tier partnerships, and the lower-tier partnership owns hot assets, then the lower-tier partnership must also revalue its assets immediately before the distribution. *Id.*

93. *Id.* The rules governing partnership revaluations are set forth in Treasury Regulation section 1.704-1(b)(2)(iv)(f). Treas. Reg. § 1.704-1(b)(2)(iv)(f) (as amended in 2016).

94. See I.R.S. Notice 2006-14, 2006-1 C.B. 498 § 3(a) (noting that "significantly fewer distributions would trigger section 751(b)" if revaluations were taken into account).

liquidating distributions.⁹⁵ Put another way, revaluations are an elective means of accounting for a transaction that alters the economic arrangement among partners. Revaluations, in many respects, function as a snapshot of a partnership immediately before a transformative event, memorializing all of the partnership's historic built-in gains and losses and, to the extent possible, "earmarking" them for the historic partners based on their historic sharing arrangement.⁹⁶ Theoretically, the treatment of revalued property mimics that of contributed property: just as section 704(c) seeks to allocate pre-contribution gains and losses to the contributing partner, the revaluation rules seek to allocate historic pre-revaluation gains and losses to the partnership's historic partners.⁹⁷

Consider, for example, a partnership with three equal partners. One of those partners would like to scale back her involvement with the enterprise; hence, the partnership makes a partially liquidating distribution of cash to her, reducing her interest in the partnership from one-third to one-fifth. This distribution is an economically transformative event for the partnership, decreasing the distributee partner's interest in the enterprise, while proportionately increasing each of the non-distributee partner's interests. Because the distribution effectively reconstitutes the partnership, the partnership may elect to revalue its assets.⁹⁸ If the partnership so elects, it would revalue its assets to reflect their fair market value at the time of the distribution, thereby giving each partner economic credit for an equal one-third share of all the partnership's pre-distribution gains and losses.⁹⁹

95. Treas. Reg. § 1.704-1(b)(2)(iv)(f). Events giving rise to revaluations include contributions, liquidating distributions, grants of partnership interests in exchange for services, and certain grants of noncompensatory partnership options. *Id.* § 1.704-1(b)(2)(iv)(f)(5). For a more detailed discussion of partnership revaluations, see generally MCKEE ET AL., *supra* note 33, ¶ 11.02; WILLIS & POSTLEWATE, *supra* note 33, ¶ 6.01.

96. If a partnership elects to revalue its assets in connection with an economically transformative transaction, then the partnership will adjust the economic, or book, value of its assets to reflect their fair market value immediately before the transaction. Treas. Reg. § 1.704-1(b)(2)(iv)(f)(1). Essentially, the partnership recognizes any economic gain or loss attributable to its assets and allocates these amounts among its partners, who will adjust their capital accounts to reflect this book gain or loss. *Id.* § 1.704-1(b)(2)(iv)(f)(2). The revaluation, however, is not a recognition event for tax purposes. Thus, revaluations raise the same difficult question that arose in the contributed property context—how should the partnership allocate the pre-revaluation gains and losses when subsequently recognized by the partnership? See *supra* note 31 and accompanying text. Given the parallels between revaluations and contributed property, it is no surprise that the Treasury looked to section 704(c) for the answer to this question. As will be discussed, a partnership is required to allocate taxable items attributable to revalued property using section 704(c) principles. *Id.* §§ 1.704-1(b)(2)(iv)(f)(4), 1.704-3(a)(6)(i) (as amended in 2013). That is, pre-revaluation gains and losses should ideally be allocated to the partnership's historic partners based on their pre-revaluation sharing arrangement. *Id.* These revalued property allocations are often referred to as "reverse" section 704(c) allocations.

97. *Id.*

98. *Id.* § 1.704-1(b)(2)(iv)(f)(5)(ii).

99. *Id.* § 1.704-1(b)(2)(iv)(f)(1)–(2).

As noted, revaluations link a partnership's historic built-in gains and losses with its historic partners. But revaluations are not recognition events; thus, they give rise to no immediate tax consequences. Instead, these historic built-in gains and losses are deferred for future recognition at a more appropriate time, such as the partnership's disposition of its property. When a taxable event does occur and the partnership recognizes these pre-valuation gains or losses, the partnership is required to allocate them among its historic partners based on their pre-valuation sharing arrangement.

Returning to the three-person partnership, consider the consequences if the partnership were to sell one of its historic properties following the partially liquidating distribution. Ordinarily, the partnership would allocate one-fifth of any recognized gain to the distributee partner based on the partnership's current post-distribution sharing arrangement.¹⁰⁰ Subchapter K's revaluation rules, however, would instead require the partnership to allocate one-third of the historic built-in gain to the distributee partner consistent with the partnership's pre-valuation sharing arrangement.¹⁰¹ In doing so, revaluations and the rules governing allocations attributable to revalued property create a link between partners and their shares of a partnership's historic built-in gains and losses. Put another way, revaluations, if elected, provide partnerships with continuity, better ensuring that a partner's share of the partnership's built-in gains and losses before a transformative event, such as a liquidating distribution, will equal her share of the same gains and losses after the event.

It is this continuity that the Treasury sought to capture when it incorporated mandatory revaluations into the Proposed 751(b) Regulations. Revaluations allow more partnerships to preserve their individual partner's shares of pre-distribution hot asset gain or loss. Taking revaluations into account under the hypothetical sales approach will thus reduce the number of distributions triggering section 751(b)—fewer distributions will cause a disparity between a partner's pre-distribution share of hot asset gain and her corresponding post-distribution share, as measured, in each case, by the partnership's hypothetical sale of its hot assets.

To illustrate, consider again the three-person partnership and its partially liquidating distribution. At the time of the distribution, let's assume that the partnership holds cash and a number of assets, including one appreciated hot asset. Absent a revaluation, a cash distribution would reduce the distributee partner's interest in the partnership's hot assets, thereby triggering section 751(b). If the partnership were to sell the hot asset before the partially liquidating distribution, it would allocate one-third of the recognized ordinary income to each partner, including the distributee partner.¹⁰² After the distribution, however, the partnership

100. I.R.C. § 704(b) (2012).

101. Treas. Reg. § 1.704-1(b)(2)(iv)(f)(4).

102. I.R.C. § 704(b).

would only allocate one-fifth of the recognized ordinary income to the distributee partner, consistent with her post-distribution interest in the partnership.¹⁰³ This distribution would thus improperly alter her share of the partnership's hot asset gain, and section 751(b) would recharacterize the transaction as a taxable exchange between her and the partnership.¹⁰⁴

If the partnership revalues its assets, as required by the Proposed 751(b) Regulations, section 751(b) would not apply to the liquidating distribution. The results of a pre-distribution hypothetical sale would be the same—the partnership would allocate to the distributee partner one-third

103. *Id.*

104. Prop. Treas. Reg. § 1.751-1(b)(2)(i)(A), 79 Fed. Reg. 65151, 65160 (Nov. 3, 2014). Section 751(b), if applicable, recharacterizes the distribution as a taxable exchange between the distributee partner and the partnership. I.R.C. § 751(b)(1). As discussed *supra* note 80, the tax consequences of a hot asset distribution have historically involved breaking the distribution into three notional transactions. Under the Proposed 751(b) Regulations, a partnership would determine the tax consequences of a hot asset distribution differently. Prop. Treas. Reg. § 1.751-1(b)(3), 79 Fed. Reg. at 65161. The proposed regulations eliminate the exchange-based approach of the former regulations, instead permitting a partnership to choose a reasonable approach that requires any partner with a section 751(b) amount immediately before the distribution to recognize a corresponding amount of ordinary gain. *Id.* § 1.751-1(b)(3)(i), 79 Fed. Reg. at 65161. That is, any partner whose share of hot asset gain decreases as a result of the distribution must recognize an ordinary gain as part of the transaction. An approach to section 751(b) is reasonable if it is consistent with section 751(b)'s purpose. *Id.* Once adopted, a partnership must apply the reasonable method consistently for all hot asset distributions. *Id.* The proposed regulations identify two approaches—the deemed sale approach and the hot asset sale approach—that are considered reasonable. *Id.* § 1.751-1(g), ex. 3(v)–(viii), 79 Fed. Reg. at 65165. The deemed sale approach is the more straightforward of the two—the partnership would recognize an ordinary gain equal to the partner's aggregate reduction in hot asset gain, allocate the gain to the relevant partners, and make corresponding basis adjustments to its hot assets and to the affected partners' bases in their partnership interests. *Id.* § 1.751-1(g), ex. 3(v), 79 Fed. Reg. at 65165; see generally N.Y. STATE BAR ASS'N TAX SECTION, *supra* note 84, at 49–50. The hot asset sale approach, in contrast, is more involved, requiring multiple notional steps to achieve a comparable result. The partnership would be treated as if it distributed zero-basis hot assets to any partner whose share of the partnership's hot asset gain is reduced in the actual distribution. Prop. Treas. Reg. § 1.751-1(g), ex. 3(vii), 79 Fed. Reg. at 65165. The partner would then be treated as selling the hot assets back to the partnership, recognizing an ordinary gain on the sale. *Id.* To complete the fictional transaction, the partner would contribute the cash received on the sale back to the partnership, and the partnership would make appropriate basis adjustments to its property. *Id.*

One advantage of shifting from an exchange-based approach to either the deemed sale approach or the hot asset sale approach is the treatment of cold assets, which no longer necessarily trigger the recognition of capital gains by a partner whose share of cold asset gain is reduced by a distribution. The proposed regulations do, however, contain a series of rules that may require or permit a distributing partner to recognize a capital gain in certain instances. *Id.* § 1.751-1(b)(3)(ii)(A) (mandatory recognition), (B) (elective recognition), 79 Fed. Reg. at 65161. Likewise, the proposed regulations contain an anti-abuse rule to combat distributions that rely on section 704(c) to defer ordinary income in a manner that is deemed to be inconsistent with the purpose of section 751(b). *Id.* § 1.751-1(b)(4). For thoughtful commentary on the hot asset sale approach, the deemed sale approach, and the treatment of capital gains under both approaches, see A.B.A. SECTION ON TAXATION, *supra* note 84; Burke, *supra* note 84; N.Y. STATE BAR ASS'N TAX SECTION, *supra* note 84.

of any ordinary income recognized on the hot asset's sale. The results of the post-distribution hypothetical sale, however, would change. As previously discussed, the rules governing revaluations require a partnership to allocate any pre-valuation gains to the historic partners based on their pre-valuation sharing arrangement.¹⁰⁵ In this instance, the partnership would allocate one-third of any pre-distribution ordinary income to the distributee partner. Before and after the distribution, the distributee partner would receive the same share of the partnership's hot asset gain. The distribution is therefore considered proportionate, and it would not trigger section 751(b).

Nonetheless, it is important to note that mandatory revaluations, are, at best, only a partial solution to the problem of hot asset distributions. Revaluations do not eliminate the need for section 751(b). On the contrary, many distributions will continue to trigger section 751(b), including complete liquidations of a partnership's interest and distributions of hot assets.¹⁰⁶ But mandatory revaluations do narrow section 751(b)'s scope, which, for many, is a welcome step in the right direction.

The Proposed 751(b) Regulations received a warm reception when published. In particular, the partnership elite were pleased, with one practitioner even commenting that the proposed regulations are “‘really great for the big players’—the larger partnerships that hire Big Four firms to comply with the tax rules.”¹⁰⁷ And this is no surprise—like the Proposed 704(c)(1)(C) Regulations, these proposed regulations signal the influence of legal craft values in partnership taxation, relying on resonance to simplify and modernize subchapter K.

Much has changed in the world of partnership taxation since the Treasury enacted the original section 751(b) regulations sixty years ago. Perhaps most importantly, our thinking about the relationship between individual partners and individual partnership gains and losses has changed, largely in response to the problem of partnership tax shelters.¹⁰⁸ Operationally, this shift is reflected in the development of rules, like those governing revaluations and contributed property, that link particular part-

105. See *supra* note 96.

106. So long as the partnership can preserve the nondistributee partners' pre-distribution share of hot asset gain in its retained assets, section 751(b) would no longer be necessary. Yet distributions involving the transfer of hot assets or the complete liquidation of a partner's interest in a partnership where the partnership may not be able to preserve each partner's share of hot asset gain, will continue to trigger section 751(b).

107. Amy S. Eliot, *Do Proposed Regs Apply to Partnerships With Only Hot Assets?*, 145 TAX NOTES 620, 620 (Nov. 10, 2014); see also Jaime Arora & Matthew R. Madara, *Practitioners Welcome Proposed Hot Asset Regulations*, 2014 TNT 212-5 (Nov. 3, 2014).

108. See Mark P. Gergen, *The End of the Revolution in Partnership Tax*, 56 SMU L. REV. 343, 351 (2003); Mark P. Gergen, *Reforming Subchapter K: Special Allocations*, 46 TAX L. REV. 1, 1 (1990) (“The flexibility of subchapter K, one of its most celebrated features, has given partners license to shift income and loss among themselves and dispose of assets while deferring recognition of gain in ways that are not otherwise possible under the income tax.”); Lokken, *supra* note 8, at 250; Monroe, *supra* note 71, at 71.

ners, particular properties, and particular built-in gains and losses. These rules have transformed subchapter K; hence, from one perspective, it makes sense that the Treasury would draw heavily on these notions to rationalize section 751(b). Once again, the priority is resonance, leveraging the partnership tax experts' familiarity and experience with elective revaluations to streamline the hot asset distribution rules. Grounding the proposed regulations in these notions is thus best viewed as an effort to ease the chronic instability associated with section 751(b).

Yet this approach to the Proposed 751(b) Regulations only works if it resonates with members of the partnership tax community. Like the Proposed 704(c)(1)(C) Regulations, there is little reason to expect that a series of rules built on the mandatory use of revaluations will resonate with the partnership mainstream. Revaluations are complicated; as a consequence, the Treasury has never mandated their use.¹⁰⁹ Although there is scant data regarding the number of partnerships that elect to revalue their assets following a triggering event, anecdotal evidence suggests that few partnerships engage in elective revaluations precisely because they are complicated.

Even the partnership elite have expressed concerns about the complexity of revaluations. For instance, when designing the Proposed 704(c)(1)(C) Regulations, the Treasury considered extending the new built-in loss rules to revalued property, but the drafters ultimately rejected this approach on complexity grounds.¹¹⁰ The New York State Bar Association, in its comments to the Proposed 704(c)(1)(C) Regulations, agreed with the Treasury's decision not to extend the proposed regulations to revalued property allocations, noting that these allocations are already a "substantial administrative undertaking" for partnerships that make elective revaluations.¹¹¹

It is thus reasonable to conclude that few in the partnership tax community have significant experience or familiarity with revaluations, and those who do are likely to be members of the partnership elite. Put another way, mainstream partnerships are likely to perceive the Proposed

109. Indeed, Notice 2006-14 would not have made revaluations mandatory. *See* I.R.S. Notice 2006-14, 2006-1 C.B. 498 § 3(a); A.B.A. SECTION OF TAXATION, *supra* note 84, at 35; N.Y. STATE BAR ASS'N TAX SECTION, *supra* note 84, at 24. Nonetheless, in certain instances, a partnership's failure to revalue its property will be carefully examined by the IRS. Treas. Reg. § 1.704-1(b)(2)(iv)(f)(5), (b)(5), ex. 14 (as amended in 2016).

110. Prop. Treas. Reg. § 1.704-3, 79 Fed. Reg. 3042, 3047 (Jan. 16, 2014). As discussed *supra* notes 95-97 and accompanying text, revalued property shares much in common with contributed property. The question thus arose as to whether built-in losses attributable to revalued property should be treated in the same manner as contributed built-in loss property, with the built-in loss quarantined through a basis adjustment personal to the historic partners. The Treasury declined to extend the principles of section 704(c) to revalued property due largely to concerns about taxpayers' ability to comply and the IRS's ability to administer these allocations in the revaluation context. *Id.*

111. N.Y. STATE BAR ASS'N TAX SECTION, REPORT NO. 1329 ON THE PROPOSED REGULATIONS UNDER SECTION 751(B), *reprinted in* 2015 TNT 175-21 (Sept. 9, 2015).

751(b) Regulations as more of the same in subchapter K—yet another exotic layer of distribution rules that are beyond their practical reach. The mainstream of the partnership tax community, its needs, and its tolerance for complexity simply do not appear to have been part of the equation in designing these regulations.

Even so, one might defend the Proposed 751(b) Regulations as a unique case because of the chronic problems associated with hot asset distributions, which have challenged partnerships across the entire partnership spectrum. Section 751(b) was once famously described as following a “five percent” rule:

[Section 751(b)’s] application is not recognized in [ninety] percent of the cases to which it applies. . . . In half the cases in which its applicability is recognized, the other remaining [ten] percent, it is ignored because the cost of complying is far greater than any revenue gain, and in, I would say, half of the remaining [five] percent, when people including the Internal Revenue Service, attempt to apply it, they do so incorrectly.¹¹²

From this vantage point, one might conclude that compliance with and enforcement of the hot asset distribution rules is so low that streamlining the rules for any category of partnerships, whether elite or mainstream, should be applauded as progress.

There is indeed some truth to this—it is hard to criticize any effort to rationalize section 751(b)’s outdated, complicated, and flawed approach to disproportionate distributions. Yet it is also important to consider the costs of the Treasury’s approach, which wields legal craft values in a manner that benefits the partnership elite at the expense of the partnership mainstream. Once again, the Treasury appears to have developed a series of rules that govern a ubiquitous partnership transaction with little appreciation for the costs that its craft-based approach would impose on the mainstream of the partnership tax community. In doing so, the proposed regulations reinforce the split in partnership taxation, signaling the role of legal craft values, complexity, and the partnership elite in shaping the law that governs all partnerships.

The time has thus come for us to talk openly about legal craft values in subchapter K. Legal craft values have influenced partnership taxation in profound ways, shaping the perspectives of an elite cadre of experts on questions ranging from tax reform to regulatory rule design to the proper level of systemic complexity in subchapter K. Likewise, legal craft values have played a significant, albeit underexplored, role in the schism that has divided partnership taxation and relegated much of the partnership main-

112. *Hearings Before the Subcomm. on Select Revenue Measures of the U.S. H. Comm. on Ways & Means on Issues Relating to Passthrough Entities*, 99th Cong., 2d Sess. 56 (1986) (statement of Joel Rabinovitz). Mr. Rabinovitz is not alone in his assessment of Section 751(b). See, e.g., AM. LAW INST., *supra* note 70, at 51 (“If the reports of noncompliance with Section 751(b) are correct, the continuance of such a provision must have an adverse bearing on taxpayer respect for the law.”); Eustice, *supra* note 81, at 383 (“Section 751(b) is difficult to understand and complex in operation, and as a consequence it is probably largely unenforced. It may be the Achilles heel of subchapter K.”).

stream to an intuitive version of subchapter K where technical compliance with the law is often impossible. With greater sensitivity to legal craft values, we may gain a fresh perspective on some of the most difficult challenges facing partnership taxation today. Perhaps most importantly, a dialogue about legal craft values may serve as a referendum on an intuitive subchapter K, forcing us to address the related questions of what it means for subchapter K to work and whom it should work for.

IV. CONCLUSION

This essay has not been easy to write. Doug taught me well—I love the technical and intellectual challenges of partnership taxation, and I take great pride in the legal craft values that infuse every rule and standard of this extraordinary system. When I first read these two proposed regulations, my initial reaction was a combination of excitement and awe. Someone at the Treasury had to develop solutions to these longstanding theoretical problems, operationalize those solutions in practical rules, and then weave the new rules into the larger web of subchapter K. I understand the theory, the language, and the operational mechanics that animate these proposed regulations; thus, the regulations do in fact resonate with me. Considered from this perspective, the proposed regulations make perfect sense, leveraging technicality and nuance in order to streamline subchapter K.

But, as I said, Doug taught me well, well enough to also understand the practical challenges that these proposed regulations are likely to create for other members of the partnership tax community. The partnership mainstream was not lucky enough to learn about revaluations and section 743(b) basis adjustments from Doug Kahn. Nor were they likely trained, as I was, to revel in legal craft values or to marvel at the legal creativity and technical skill of the partnership tax specialist. On the contrary, the partnership mainstream often lacks access to the elite tax advice necessary to navigate subchapter K. The partnership mainstream is thus left in an impossible situation, faced with insurmountable complexity and no viable path to technical compliance. Even worse, this divide within the partnership tax community risks perpetuating the dangerous perception that subchapter K is designed for the wealthy, the sophisticated, and the well advised rather than for the partnership mainstream.

I have written about my own struggles reconciling legal craft values and practical functionality elsewhere; thus, I will not repeat my conclusions here.¹¹³ My only goal in this essay is to highlight the conflict, illustrating the impact of legal craft values on the law, scholarship, and reform of partnership taxation. Despite my deep appreciation for legal craft values, I am not convinced that subchapter K works well for the great major-

113. See Andrea R. Monroe, *Subchapter K, Gateway Drugs, and Tax Reform*, 148 TAX NOTES 1229 (Sept. 14, 2015).

ity of the partnership tax community. And, to me, an intuitive subchapter K is not a substitute for the rule of law.

There is, however, an additional reason why this essay was hard to write—I suspect that Doug will disagree with much of it. For someone like me who has spent the last nineteen years hoping to one day deserve all the faith and support Doug has given me, this is quite a disconcerting thought. The more I struggled with this reality, though, the more I came to believe that it was perhaps the most fitting way to honor Doug. Anyone who has had the pleasure of meeting Doug likely knows how much he enjoys a good disagreement, and I doubt that will change in retirement. Thus, I hope that this essay is just the beginning of another friendly disagreement about the merits of an intuitive subchapter K and the more universal problem of complexity in partnership taxation.

Thank you, Doug. Thank you for being the best teacher I ever had, the one that caused me to fall in love with tax.